



# MONTANA LEGISLATIVE BRANCH

## Legislative Fiscal Division

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Legislative Fiscal Analyst  
CLAYTON SCHENCK

EXHIBIT 5  
DATE 1-26-09  
in format

AD

DATE: January 23, 2009

TO: Senator Bob Story, Senate President  
Rep. Bob Bergren, House Speaker  
Senator Keith Bales, Chair, Senate Finance Committee  
Rep. Bob Lake, Chair, House Taxation Committee  
Senator Jeff Essmann, Chair, Senate Taxation  
Rep. Jon Sesso, Chair, House Appropriations Committee

FROM: Terry W. Johnson, Principal Fiscal Analyst *TWJ*

RE: General Fund Revenue Trends

### PURPOSE OF REPORT

During a recent meeting with House and Senate leadership, the Legislative Fiscal Division (LFD) told legislators that LFD staff would provide periodic updates on the rapidly changing economic conditions and the potential impact on general fund revenue estimates. It is critical for the legislature to be apprised of these impacts in order to craft a state budget that is balanced as required by the constitution. The estimates provided in this report are based on economic conditions and trends observed at this time and are subject to change as more information becomes available.

This is the first report designed to update the legislature on recent economic trends and the corresponding outlook for FY 2009, 2010, and 2011 general fund revenue estimates. This analysis is based on data received through early January 2009 and does not include any potential economic impacts of the proposed federal economic stimulus package. This report is presented in three sections. The first section summarizes the type of new information that has become available to the LFD since our revised revenue estimate recommendations were prepared in mid-December, 2008. The second section summarizes the results of our analysis and the impact on anticipated general fund revenue collections. And the third section, provides a "what to watch for" in the next update of this report expected to be issued in mid-February.

### THE BOTTOM LINE

The LFD estimates used in our pre-session budget analysis were based on data received as of early December 2008. At that time, the revised LFD recommendations were \$135 million below the RTIC November estimate for FY 2009, 2010, and 2011. This revised analysis shows that there is an additional \$85 million below the RTIC estimates for a total reduction of \$220 million for the three year period. The next section of the report summarizes our analysis.

## **NEW INFORMATION**

Each month, the Legislative Fiscal Division (LFD) receives a revised national economic outlook from IHS Global Insight (IHS). This is the economic forecasting company that Montana has a contract with to provide national and regional economic forecasting services. This service includes written material as well as a variety of economic forecasts for “hundreds” of economic variables. The information received from IHS in early January reflects their forecasts as of December 2008.

The statewide budgeting and accounting system (SABHRS) produces a “snapshot” of accounting transactions on the last day of each month. The LFD has internal computer processes to download this data and produce a variety of reports and spreadsheets. While this data is critical in monitoring year to date collection trends, this system does not contain any tax return or economic information such as individual and corporate income components, oil and gas production, and prevailing interest rates. This type of detailed data must be extracted from other sources provided the information is available. The accounting transaction detail that is available to the LFD reflects revenue collections through December 2008. Historical collection data by month is available back to FY 2000.

The LFD, in cooperation with the Department of Revenue (DOR), developed a process whereby the DOR sends the LFD tax return data for fifty different tax types at the beginning of each month. This data is extremely helpful in analyzing various trends that may be occurring within a given tax type. For example, the DOR data shows oil production by calendar quarter as reported by the taxpayer. This data is invaluable in tracking production trends throughout the year. It should be noted, however, that since oil production taxes are payable sixty days after the end of quarter, there is a considerable lag time before the LFD can analyze the data. Nonetheless, this new data was received January 1 and included return information captured in the DOR system as of December 31, 2008.

During each month, there are numerous articles and economic reports that are produced by newspapers, economic websites, and federal entities. To the extent possible, this information is reviewed for relevancy to Montana’s economy and the impact it may have on state revenues. Usually this information is for reference and does not necessarily have a quantifiable impact on our revenue outlook. This type of information is received daily throughout the month.

Based on this new information, the following section of the report highlights our analysis of the new data and summarizes the impacts on the general fund revenue estimates for FY 2009, 2010, and 2011.

## **RESULTS OF LFD ANALYSIS**

The primary components of total general fund revenues are individual and corporate income taxes, property taxes, investment earnings, and natural resource taxes. If all of these components are added together, almost 75 percent of total general fund revenues are produced from these sources. The analysis included in this report is focused on selected components of individual and corporate income tax, property tax, investable balances and interest rates, and commodity prices (oil, gas, metals). The remaining sources of general fund revenue are fairly stable and are not subject to the same wide variations as the major sources mentioned above.

### **Individual Income Tax**

Individual income tax assumptions for selected income components were analyzed based on new IHS data. These components were wage and salary, capital gains, interest, dividend, rent, royalty and

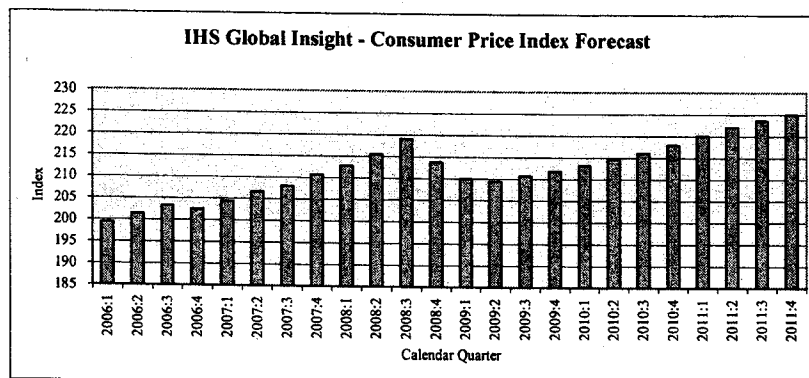
partnership incomes. The consumer price index forecasts of IHS were also reviewed. Based on this data, the individual income tax estimates are shown in Figure 1. The estimates as adopted by RTIC on November 18 (HJ2) and the LFD recommendations developed in December are shown for reference. The change amount is calculated by comparing the HJ2 estimate with the January LFD analysis. A negative number means our new estimate is below the amount contained in HJ2.

Figure 1

Individual Income Tax (in millions)		Estimated	Estimated	Estimated	Estimated
Month	General Fund Revenue Estimate	FY 2009	FY 2010	FY 2011	3 Year Total
November	Rev. & Transportation Committee (HJ2)	\$871.653	\$884.934	\$908.994	\$2,665.581
December	LFD Recommendations	854.823	856.291	880.781	2,591.895
January	LFD Analysis	<u>851.275</u>	<u>839.189</u>	<u>860.512</u>	<u>2,550.976</u>
Change Amount (HJ2 to LFD Analysis)		(\$20.378)	(\$45.745)	(\$48.482)	(\$114.605)

The SABHRS collections data through December can be helpful as a confirmation of the FY 2009 estimate. By using this information and the extrapolation of the remaining six months of the fiscal year, an independent estimate for FY 2009 can be derived. This technique should be viewed as a reasonableness check and not as an estimate based on underlying economic factors. The collections data through December supports the January LFD estimate for FY 2009.

Figure 1A



It should also be pointed out that IHS is forecasting deflation as shown in Figure 1A. Because the federal and state's tax structures are adjusted for the affects of inflation, "deflation" has the affect of increasing a taxpayers liability and thus state revenues provided there is growth in income. This occurs because tax brackets, personal exemptions, and

standard deduction amounts are decreased by the rate of deflation. Because this unusual event could impact taxpayers adversely during an economic recession, the legislature may want to address this issue during the session.

## Corporation Income Tax

Corporation income tax assumptions for selected economic variables were analyzed based on new IHS data. These variables were consumer consumption expenditures, US pre-tax profits, financial sector data (loans, interest rates, etc.) and commodity prices. Based on this data, the corporation income tax estimates are shown in Figure 2. The estimates as adopted by RTIC on November 18 (HJ2) and the LFD recommendations developed in December are shown for reference. The change amount is calculated by comparing the HJ2 estimate with the January LFD analysis. A negative number means our new estimate is below the amount contained in HJ2.

Figure 2

Corporation Income Tax (in millions)		Estimated	Estimated	Estimated	Estimated
Month	General Fund Revenue Estimate	FY 2009	FY 2010	FY 2011	3 Year Total
November	Rev. & Transportation Committee (HJ2)	\$156.132	\$136.293	\$149.352	\$441.777
December	LFD Recommendations	154.838	125.911	133.674	414.423
January	LFD Analysis	<u>150.760</u>	<u>119.115</u>	<u>128.571</u>	<u>398.446</u>
Change Amount (HJ2 to LFD Analysis)		(\$5.372)	(\$17.178)	(\$20.781)	(\$43.331)

The SABHRS collections data through December can be helpful as a confirmation of the FY 2009 estimate. By using this information and the extrapolation of the remaining six months of the fiscal year, an independent estimate for FY 2009 can be derived. This technique should be viewed as a reasonableness check and not as an estimate based on underlying economic factors. The collections data through December suggests the January LFD estimate is too conservative for FY 2009. However, because corporations can adjust their subsequent estimated payments downward, our office is anticipating this will occur for the last two estimated payments to be received in FY 2009. The next estimated payment is due March 15.

## Oil and Gas Production Tax

Both oil and gas production and price assumptions were analyzed based on new IHS and DOR data. Based on this data, the oil and gas production general fund estimates are shown in Figure 1. The estimates as adopted by RTIC on November 18 (HJ2) and the LFD recommendations developed in December are shown for reference. The change amount is calculated by comparing the HJ2 estimate with the January LFD analysis. A negative number means our new estimate is below the amount contained in HJ2.

Figure 3

Oil & Gas Production Tax (in millions)		Estimated	Estimated	Estimated	Estimated
Month	General Fund Revenue Estimate	FY 2009	FY 2010	FY 2011	3 Year Total
November	Rev. & Transportation Committee (HJ2)	\$116.771	\$100.066	\$105.177	\$322.014
December	LFD Recommendations	106.600	84.323	102.825	293.748
January	LFD Analysis	<u>96.342</u>	<u>69.921</u>	<u>94.393</u>	<u>260.656</u>
Change Amount (HJ2 to LFD Analysis)		(\$20.429)	(\$30.145)	(\$10.784)	(\$61.358)

Figures 3A and 3B show the underlying assumptions for Montana's oil production and price. As seen from Figure 3A, total production is expected to decline significantly, over thirty percent from calendar 2007 to estimated calendar 2011. This trend is based on tax return data for the first three quarters of calendar 2008 compared to the same period of calendar 2007. With the outlook for prices to remain well below previous levels and the limited number of oil rigs in Montana, the probability of this production decline abating is very low.

As shown in Figure 3B, Montana oil prices are expected to average slightly over \$30 per barrel during calendar 2009. While staff has received several comments about Montana oil selling for far less than this amount, it should be pointed out that this is an average price for all grades of oil and represents an average price for the entire calendar year. Oil prices are expected to edge upward in calendar 2010 and 2011 as the nation begins to recover from the economic recession.

Figure 3A

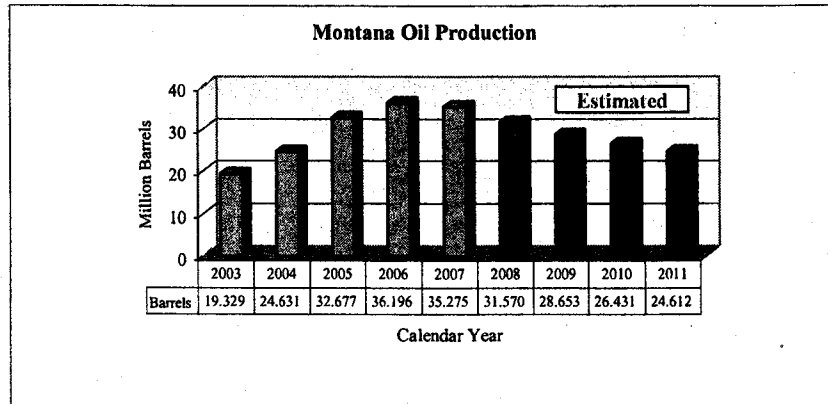
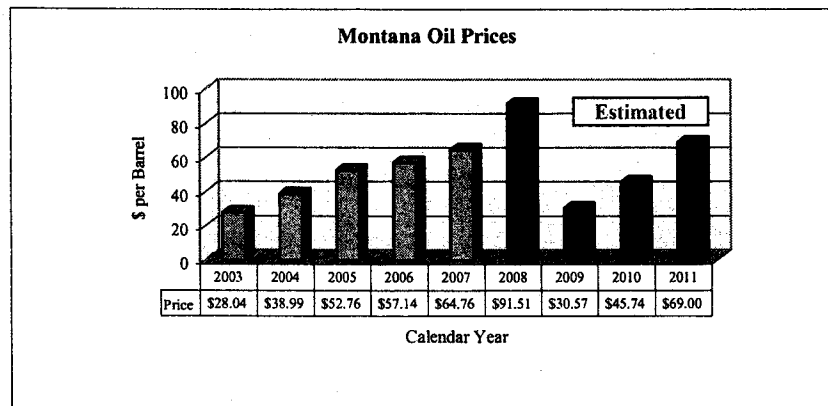


Figure 3B



## US Mineral Royalty

The adjustment to the US mineral royalty estimate is the result of the changes in the assumptions for oil and gas production and price. Based on this data, the US mineral royalty estimates are shown in Figure 3. The estimates as adopted by RTIC on November 18 (HJ2) and the LFD recommendations developed in December are shown for reference. The change amount is calculated by comparing the HJ2 estimate with the January LFD analysis. A negative number means our new estimate is below the amount contained in HJ2.

Figure 3

US Mineral Royalties (in millions)		Estimated	Estimated	Estimated	Estimated
Month	General Fund Revenue Estimate	FY 2009	FY 2010	FY 2011	3 Year Total
November	Rev. & Transportation Committee (HJ2)	\$28.259	\$31.518	\$32.505	\$92.282
December	LFD Recommendations	26.311	29.641	32.113	88.065
January	LFD Analysis	<u>24.953</u>	<u>28.457</u>	<u>32.861</u>	<u>86.271</u>
Change Amount (HJ2 to LFD Analysis)		(\$3.306)	(\$3.061)	\$0.356	(\$6.011)

## Metalliferous Mines Tax

The metalliferous mines tax was adjusted to reflect the significant drop in several metal prices. Reductions in the price estimates were made for the following commodities: copper, silver, lead, zinc, platinum, palladium, and molybdenum. Adjustments for calendar 2008 prices were based on return data for the first six months combined with estimated prices for the remainder of calendar 2008. Estimates for calendar 2009 through 2011 were based on current prices. Based on this data, the metalliferous mines tax estimates are shown in Figure 4. The estimates as adopted by RTIC on November 18 (HJ2) and the LFD recommendations developed in December are shown for reference. The change amount is calculated by comparing the HJ2 estimate with the January LFD analysis. A negative number means our new estimate is below the amount contained in HJ2.

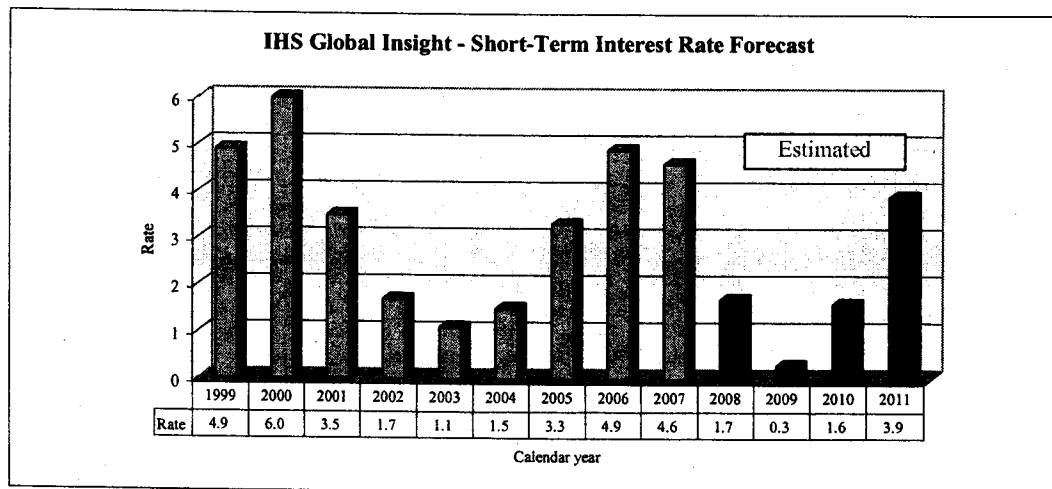
Figure 4

Metalliferous Mines Tax (in millions)		Estimated	Estimated	Estimated	Estimated
Month	General Fund Revenue Estimate	FY 2009	FY 2010	FY 2011	3 Year Total
November	Rev. & Transportation Committee (HJ2)	\$9.854	\$8.085	\$8.066	\$26.005
December	LFD Recommendations	8.666	5.294	5.278	19.238
January	LFD Analysis	<u>6.777</u>	<u>3.248</u>	<u>3.279</u>	<u>13.304</u>
Change Amount (HJ2 to LFD Analysis)		(\$3.077)	(\$4.837)	(\$4.787)	(\$12.701)

## Treasury Cash Account Interest

The treasury cash account interest estimate is impacted by the underlying assumptions for short-term interest rates and cash available for investment. Short-term interest rates as estimated by IHS are at historical low levels for calendar 2009 with a modest improvement in 2010 and a return to a more normal rate by calendar 2011. Figure 5A shows the historical and forecast rates as prepared by IHS.

Figure 5A



After a review of current investment income and the average daily cash balance in the treasury cash account, the average cash balance was adjusted upward to reflect the current trends as well as the legislature's desire to maintain an ending fund balance consistent with the level recommended by the executive. Based on this data, the treasury cash account interest estimates are shown in Figure 5. The estimates as adopted by RTIC on November 18 (HJ2) and the LFD recommendations developed in December are shown for reference. The change amount is calculated by comparing the HJ2 estimate with

the January LFD analysis. A positive number means our new estimate is above the amount contained in HJ2.

**Figure 5**

Treasury Cash Account Interest (in millions)		Estimated	Estimated	Estimated	Estimated
Month	General Fund Revenue Estimate	FY 2009	FY 2010	FY 2011	3 Year Total
November	Rev. & Transportation Committee (HJ2)	\$11.107	\$10.185	\$19.381	\$40.673
December	LFD Recommendations	9.541	8.905	19.265	37.711
January	LFD Analysis	<u>16.341</u>	<u>11.178</u>	<u>25.124</u>	<u>52.643</u>
Change Amount (HJ2 to LFD Analysis)		\$5.234	\$0.993	\$5.743	\$11.970

## Property Tax

Since the RTIC meeting in November, revised property tax values from the DOR were received for FY 2009. These new values were incorporated into the estimates. In addition, two court cases were resolved that impacted property tax estimates. Northwestern settled its case with the state and the Montana Supreme Court ruled in favor of Omimex over the proper classification of its pipeline properties. The impacts of these cases have been incorporated into the estimates. Based on this data, property tax estimates are shown in Figure 6. The estimates as adopted by RTIC on November 18 (HJ2) and the LFD recommendations developed in December are shown for reference. The change amount is calculated by comparing the HJ2 estimate with the January LFD analysis. A positive number means our new estimate is above the amount contained in HJ2.

**Figure 6**

Property Tax (in millions)		Estimated	Estimated	Estimated	Estimated
Month	General Fund Revenue Estimate	FY 2009	FY 2010	FY 2011	3 Year Total
November	Rev. & Transportation Committee (HJ2)	\$211.495	\$222.983	\$228.933	\$663.411
December	LFD Recommendations	214.615	226.382	230.363	671.360
January	LFD Analysis	<u>214.615</u>	<u>225.628</u>	<u>229.428</u>	<u>669.671</u>
Change Amount (HJ2 to LFD Analysis)		\$3.120	\$2.645	\$0.495	\$6.260

## Summary of LFD Analysis

Based on our analysis of the new data received from all the sources mentioned previously, the information indicates that total general fund revenue estimates could be overstated by \$220 million as compared to the revenue estimates contained in HJ2. A majority of this amount is due to the change in the underlying assumptions for individual income tax, corporation income tax, and oil and gas production tax.

The LFD estimates used for our pre-session budget analysis were \$135 million below the RTIC November estimate. This revised analysis shows an additional \$85 million below the RTIC estimates for a total change of \$220 million.

Figure 7

Totals For Selected Sources (in millions)		Estimated	Estimated	Estimated	Estimated
Month	General Fund Revenue Estimate	FY 2009	FY 2010	FY 2011	3 Year Total
November	Rev. & Transportation Committee (HJ2)	\$1,405.271	\$1,394.064	\$1,452.408	\$4,251.743
December	LFD Recommendations	1,375.394	1,336.747	1,404.299	4,116.440
January	LFD Analysis	<u>1,361.063</u>	<u>1,296.736</u>	<u>1,374.168</u>	<u>4,031.967</u>
Change Amount (HJ2 to LFD Analysis)		(\$44.208)	(\$97.328)	(\$78.240)	(\$219.776)

## WHAT TO WATCH FOR NEXT MONTH

This section of the report highlights what new data will be available between now and mid-February. This data should help staff and the legislature to assess any new trends that may be developing with general fund revenue estimates.

### Data to be Received

- January 27      Annual Economic Outlook Seminar, Bureau of Business & Economic Research  
Great Northern Hotel, Helena, Montana
- Late January      IHS Global Insight, Montana economic forecast  
Written report and data tables
- Early February      IHS Global Insight, Nation economic forecast  
Written report and data tables
- SABHRS month-end data
- General fund revenue monitoring report – revenue collections through January
- Second quarter (FY 2009) estimated payment  
for individual and corporation income tax
- Third quarter (calendar 2008) oil and gas tax payment
- Second quarter (FY 2009) coal severance tax payment
- DOR selected tax return data